EXPERIENCE IS THE TEACHER OF ALL THINGS. IMPROVING ENFORCEMENT DECISIONS THROUGH EX-POST EVALUATION.

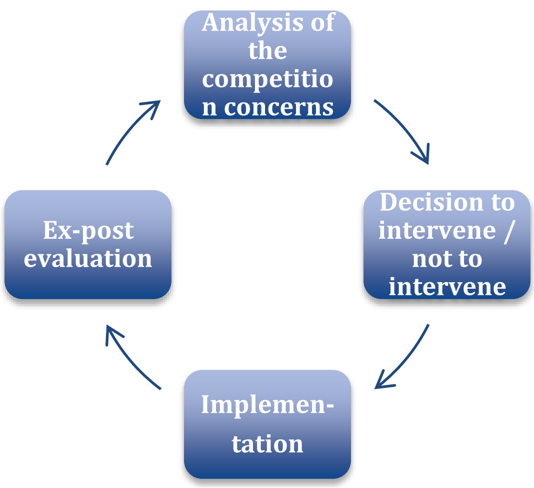
By Silvia Carrieri[1]

"Experience is the teacher of all things", Julius Caesar once said.[2] In the realm of competition enforcement, ex-post evaluation can be a powerful tool for grasping the teacher's lessons.

An **ex-post evaluation** is an examination of a Competition Authority's decision[3] that satisfies 3 criteria: (i) it is performed to determine what has been the impact of the decision on the affected market, relative to alternative scenario(s); (ii) it is performed sometime after the decision; and (iii) it is based on the use of ex-post data. Ex-post data consist of the information that was not available to Competition Authorities at the moment when they took the decision, for example whether entry would occur or how prices would evolve.

The number of ex-post evaluation studies has grown considerably in the last decade: more authorities are undertaking them or are planning to do so, and academics are getting more and more involved in this area of work. But why is this the case? What **benefits** can a Competition Authority obtain from ex-post evaluations?

First, many Competition Authorities perform ex-post evaluations to improve **decision making** to better design future interventions. To reach this objective, ex-post evaluations should be incorporated in the decision-making process, as shown in the figure below.



Learning from past experiences is necessary because enforcement decisions are taken in conditions of uncertainty. This calls for their evaluation to determine which forecasts, assumptions and hypotheses proved to be true and which did not. Ex-post evaluations can therefore try to determine if the decision was the appropriate one and why, but could also have a narrower scope and focus on some specific elements of the decision. They can for example just test key assumptions and expectations, or the effectiveness of remedies. They can aim at improving analytical tools and economic theories. Often, they are used to better understand competition in specific sectors.

The benefits from ex-post evaluation are maximized when the studies are performed **regularly**. Indeed, a few studies can provide valuable information, but only regular evaluations can identify patterns over time or recurrences in specific sectors.

A second but equally important goal is **advocacy**. Measuring the impact of their activities on markets and consumers allows Competition Authorities (CAs) to justify their work and budget to stakeholders and governments. This holds as well for policy areas other than competition enforcement: this is why in OECD countries more and more institutions across different policy fields are starting to perform ex-post evaluation.

The hospital merger retrospective[4] performed by the US Federal Trade Commission ("FTC") constitutes a powerful example of how ex-post evaluations can simultaneously serve advocacy purposes, improve analytical tools and clarify how competition works in a specific sector. In the late 1990s, the US Department of Justice ("DoJ") and FTC lost seven consecutive hospital merger cases in court. That is why, at the beginning of the 2000s, the FTC decided to conduct retrospective analyses of four consummated hospital mergers. The findings provided important methodological insights:

- the method used at the time to establish market definition – the so-called Elzinga-Hogarty method - resulted in geographical markets that were too large
- not-for-profit hospitals actually exercise market power instead of acting in the community interest, as was previously believed
- the bargaining process between hospitals and insurers needs to be appropriately modeled and taken into account

Thanks to these lessons, the FTC was able to reverse the trend and successfully challenge the Evanston/Northwestern/Highland Park merger in court. The FTC prospective merger program in the hospital sector is now very active: six mergers have been blocked or abandoned since 2008.

In practice, the ex-post evaluation process consists of nine steps:

1. Selecting the decision to assess
2. Choosing the evaluation team
3. Identifying the counterfactual, that is, the hypothetical scenario assuming that a different decision had been taken
4. Selecting the methodology to use
5. Determining the variables to study (price, quality, variety)
6. Collecting the necessary data and information
7. Performing the analysis
8. Verifying the robustness of the results
9. Drawing conclusions and derive lessons

Each of these steps requires careful consideration to assure that the assessment reaches robust conclusions. For example, should the evaluation team consist of internal staff or external consultants? Should the ex-post evaluation only consider the effect of the decision on prices or also on other factors such as quality and variety of the product mix? What type of data is needed and where can the information be found?

It is precisely in order to answer these questions and to provide guidance to Competition Authorities on the correct design and performance of ex-post evaluations that the OECD has decided to publish a *Reference Guide on the Ex-Post Evaluation of Competition Agencies' Enforcement Decisions* (forthcoming). The Guide contains an in-depth overview of all the issues linked to ex-post assessments and constitutes an excellent resource both for CAs who are planning to start performing ex-post evaluations and for those who already do it but want to improve the quality of their assessment.

The Guide is also rich in examples and references, to show how previous studies solved the practical problems encountered in the design and performance of the analysis. For example, as point 3 above indicates, there are cases in which identifying the counterfactual scenario of the decision is not straightforward: more than one counterfactual may be possible for a single decision. This happens, for instance, in case of conditionally cleared mergers: the possible alternative scenarios are merger prohibition, unconditional clearance or conditional clearance with a different set of remedies.

Usually only one counterfactual scenario is examined in the ex-post evaluation. The most likely alternative to the decision that was actually taken is typically chosen as a counterfactual. However, Friberg and Romahn (2014)[5] provide an example of an ex-post evaluation using **more than one counterfactual**. The two authors assess the impact of the merger between Calsberg and Pripps in the Swedish beer market. Given that the merger was cleared conditional on the divestiture of some brands, they examine three different counterfactual scenarios: (i) merger prohibition, (ii) unconditional clearance, and (iii) conditional clearance with a different set of remedies. Using two different methodologies, Friberg and Romahn find that beer prices would have been lower if the merger had not been allowed. Yet, divestitures had a beneficial effect in limiting the post-merger price increase. Such effect would have been smaller if the divested brands, instead of being bought by a small rival firm, had been acquired by the merging parties' biggest competitor.

For an ex-post evaluation to obtain robust results, not only the counterfactual must be carefully chosen, but also the methodology. This requires, among other things, the identification of the correct **time frame** for the analysis. For instance, a merger will often simultaneously have an anticompetitive effect due to the increased market power and a pro competitive effect driven by efficiencies. However, the two effects do not necessarily take the same time to manifest themselves. If the time-horizon analyzed is too short, the assessment may observe the partial effect of the merger and miss the overall one.

Focarelli and Panetta (2003)[6] provide a seminal example of an assessment of the **short term and long term effects** of a merger. The authors assume that the anticompetitive effect a merger will happen soon after the acquisition, because the newly acquired market power can immediately be exploited. The pro competitive effect will instead appear later, since efficiencies take some time to materialize. Focarelli and Panetta thus assess a series of mergers in the retail deposit market in Italy in the 1990s. The findings of the study prove that their assumptions were correct: prices increase in the transition period (from the year of the merger until two years after the merger) but decrease during the completion period (from three to five years after the merger). The pro competitive effect of the merger completely outweighs the anticompetitive one, and the overall impact is a decrease in price. If the researchers had adopted a shorter time frame, the conclusions may have been very different.

If what we have seen above is true and ex-post evaluations are truly useful, then why are many agencies still not performing them? An often-cited reason is the fear that excessive resources are required, in terms of time, money and staff. This is not necessarily true. Of course, ex-post evaluation is not a trivial exercise. Yet, valuable results can also be obtained from simplified approaches, for example using qualitative methodologies.

An excellent example is the study carried out by the New Zealand Commerce Commission, *Targeted Ex Post Evaluations in a Data Poor World.*[7] The study was aimed at testing the validity of specific expectations on anticipated market developments. Therefore, it targeted mergers that were cleared because the competition concerns were expected to be resolved by factors such as low barriers to entry, divestitures or buyers' countervailing power. Gathering data was neither too complex nor expensive, because the assessment was based on publicly available information and on interviews with market participants. The Commission then tested whether the hypotheses that had led to the merger clearances had proven correct. Results showed, for example, the importance of taking into account exchange rates when predicting import competition and the role of sunk costs in entry decisions. The New Zealand approach thus proves that informative ex-post evaluations can be undertaken despite constraints in terms of time, data availability and resources.

Another recurrent concern among Competition Agencies is: What if the ex-post evaluation reaches negative conclusions and points out **mistakes**? Should the study be published or not? Will the agency's reputation be damaged? Could it lead to a lawsuit?

Some reassuring considerations are due. First, an unexpected evolution of the market does not necessarily imply that the authority made a mistake. Unpredictable circumstances may have occurred, or incorrect information could have been provided. Even when the assessment points out a mistake in the analysis, the experience of the most active CAs (the UK CMA, the Dutch NMA, the US FTC and DoJ) is encouraging: making the assessment public did not cause them reputational damages or subsequent lawsuits.

Yet, risks cannot be completely ruled out: each agency must weigh pros and cons. Publishing every ex-post evaluation contributes to the transparency and accountability of the authority. At the same time, this could cause a bias in the choice of the decisions to assess: authorities may have an incentive to only evaluate cases that are likely to reach positive conclusions. One approach may be to decide on the publication of results on a case-by-case basis.

In conclusion, Competition Authorities willing to improve their efficacy and to advocate the value of their work should consider ex-post evaluations as a valuable tool for this purpose. Great benefits come from such an exercise, and constraints in terms of time, data availability and resources can be overcome through the use of simplified approaches. The OECD *Reference Guide on the Ex-Post Evaluation of Competition Agencies' Enforcement Decisions* constitutes a helpful resource for competition agencies. The in-depth overview and the numerous examples included in the Guide will provide authorities with guidance through the design and implementation of ex-post assessments, in order to help them make the most out of their past experience.

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Find out more about the OECD's work on the evaluation of competition interventions at http://www.oecd.org/daf/competition/evaluationofcompetitioninterventions.htm

[1] The views expressed in this article are those of the author and do not necessarily represent the views of the OECD, and/or of the OECD Competition Committee or any of its members. An earlier version of this article was published in the newsletter of the OECD-GVH Regional Centre for Competition, Issue No. 6, January 2016 http://www.oecd.org/daf/competition/hungarycentrenewsletter.htm

[2] Julius Caesar, *Commentarii de Bello Civili* (Commentaries on the Civil War), 2.8

[3] Ex-post evaluations can be performed for antitrust decisions (mergers, agreements, abuses), for market studies or for other types of interventions. Anyway, this article focuses only on ex-post evaluations of antitrust decisions.

[4] The studies are published in a special volume of the *International Journal of the Economics of Business* (Volume 18, Issue 1, 2011) http://www.tandfonline.com/toc/cijb20/18/1

[5] Friberg, R., & Romahn, A. (2014). Divestiture Requirements as a Tool for Competition Policy: A Case from the Swedish Beer Market. *International Journal of Industrial Organization*, 42, 1-18

[6] Focarelli, D., & Panetta, F. (2003). Are Mergers Beneficial to Consumers? Evidence from the Market for Bank Deposits. *American Economic Review, 93*(4), 1152-1172.

[7] Csorgo, L. & Chitale, H. (2015). *Targeted Ex Post Evaluations in a Data Poor World*. New Zealand Commerce Commission. http://www.comcom.govt.nz/the-commission/media-centre/speeches/targeted-ex-post-evaluations-in-a-data-poor-world/